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Solicitor General of the United States,
Counsel for Petitioner.

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In the Supreme Court
OF THE
United States

October Term, 1938

No. 304

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,

vs.

Chester N. Weaver Company (a corporation),
Respondent.

BRIEF FOR RESPONDENT.

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San Francisco, California,
November 2, 1938.

TO THE HONORABLE JUSTICES
OF THE SUPREME COURT OF THE
UNITED STATES:

The printing of the attached brief was completed this day and forwarded immediately for timely filing with the Clerk of the Court as prescribed by paragraph 3 of Rule 27. This brief was prepared in reply to a typewritten proof of a brief received by us from the Solicitor General on October 24, 1938.

This day (after this brief was printed and one week after the time allowed by paragraph 1 of Rule 27 for petitioner to file its brief) we received a typewritten redraft of petitioner's proposed brief. The redraft materially changes the attitude and argument contained in the first proof and its accompanying letter intimates further possible changes.

In order to comply with the rules of this Court, we will be unable to rewrite and print a brief replying to petitioner's tardy amended brief or to await further changes and file the same within the time allowed by the Rule 27. Therefore, this brief is respectfully submitted as reply to petitioner's original argument.

ADOLPHUS E. GRAUPNER,
ARTHUR E. COOLEY,
Counsel for Petitioner.

In the Supreme Court
OF THE
United States

October Term, 1938

No. 304

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,

vs.

Chester N. Weaver Company (a corporation),
Respondent.

BRIEF FOR RESPONDENT.

I. INTRODUCTORY STATEMENT.

Petitioner's brief contains certain statements which are erroneous or faulty in conclusion. To these we first refer, in order that the Court may more readily appreciate respondent's position.

1. Petitioner seeks to involve section 101 of the Revenue Act of 1932 (c. 209, 47 Stat. 169) and the cases of *White v. United States*, Nos. 96 and 97 on the present calendar in this case. Section 101 relates to capital gains and losses, which are not herein involved, and by its

expressed terms is not applicable to corporations, *White v. United States* does not involve section 23(r)(d) of the 1932 Act, upon which petitioner rests its case.

2. Petitioner assigns its errors to make it appear that the deduction approved by the Court below had been allowed on severance of the statute involved rather than considering the applicable provisions as a whole. The decision of the Court below discloses that it considered all other provisions of the Revenue Act of 1932 relating to deductions, including section 23(r)(1).

3. Also, in the opening statement of its argument petitioner erroneously assumes that respondent has not "pointed to an applicable statute" under which it is entitled to a deduction.

Respondent, throughout the progress of this case, has called attention to specific statutory provisions which entitle it to the deduction sought and the Court below gave careful attention to each of the statutory provisions to which its attention was called, viz: Sections 22(d), 115(c), 111 and 112 of the Revenue Act of 1932 (c. 209, 47 Stat. 169). These are specific statutes relating to a particular matter, whereas section 23 is a general statute covering deductions generally.

However, as we have constantly asserted, if this complete specific statutory procedure relating to distributions by corporations did not exist, the only part of the general statute that could possibly apply here would be section 23(f) and not section 23(r)(1), because the latter applies only to "sales or exchanges", and a distribution *required by law* on dissolution of a corporation is neither a sale or exchange.

II. SUMMARY OF ARGUMENT.

1. The position of petitioner that the loss herein involved is not deductible under section 23(r)(1) of the Revenue Act of 1932 (c. 209, 47 Stat. 169, Appendix p. ii) requires it to establish that the words "sales or exchanges" as used in said section have a meaning extended beyond the ordinary definition of those words. If there was no "sale" or "exchange" then petitioner must fail.

2. Under section 22(d), 115(c), 111 and 112 respondent is entitled to deduction of its loss, without reference to any other sections of the Revenue Act of 1932.

3. Further, under sections 22(d), 115(c), 111 and 112 of the same Act (Appendix pp. i, ii, iii) respondent is entitled to deduct the loss sustained under section 23(f), despite the provisions of section 23(r)(1).

4. Petitioner's arguments on other points are inadequate to sustain its position in seeking to deprive respondent of right to deduction.

III. ARGUMENT.

The order of argument contained in petitioner's brief herein is altered for what we believe to be a more logical analysis of the petitioner's attack upon the decision of the Court below:

1. THE LOSS CANNOT BE DENIED BECAUSE OF ANY APPLICABILITY OF SECTION 23(r)(1).

Because the majority of the Court below considered that section 23(r)(1) was not applicable to limit the de-

duction sought by respondent and because the minority relied upon the same section to sustain its dissent we believe that section should be first discussed.

Throughout the progress of this case from the Bureau of Internal Revenue to this Court the government has conceded that the amount involved herein would have been deductible under section 23(f), if it were not for what it asserts to be a controlling limitation in section 23(r)(1). Section 23(f) provides that in computing net income there shall be allowed as a deduction:

> "(f) Subject to the limitations provided in subsection (r) of this section, in the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

The whole of subsection 23(r) is not involved. That portion upon which petitioner relies reads as follows:

> "(r) **Limitation on Stock Losses**—(1) Losses from *sales or exchanges* of stocks and bonds * * * which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of its own obligations)." (Italics supplied.)

There is no controversy over the character of the assets involved in the transaction before the Court. It is conceded that they were not capital assets.

The majority opinion holds that section 23(r)(1) is not applicable to limit deductions for losses sustained on the distribution of the remaining assets in complete liquidation of an insolvent corporation (R. p. 69), while the minority opinion holds to the contrary. (R. p. 71.)

Petitioner lays great stress on the dissent to the decision of the Court below. The premise of fact in that dissent is that the "holders of all the preferred stock of the Townsend Company, surrendered their stock certificates for cancellation and for the purpose of completing liquidation and effecting the dissolution of that company." (R. 71.)

From that premise, Judge Stephens reaches the conclusion that the transaction was a sale or exchange within the meaning of section 23(r)(1). The statement of fact is correct, but the facts on which he relies destroy the effectiveness of the conclusion he reaches.

Considering all of the sections heretofore and hereinafter discussed, the minority judge rejects the applicability of all, excepting sections 23(f) and 23(r)(1), and applying those subsections in conjunction with sections 11, 12, 13 and 21 of the Revenue Act of 1932, reaches a conclusion which is based on the following facts (R. 71):

1. The Townsend Company became financially involved and unable to continue business;

2. The stockholders took the necessary steps to dissolve and liquidate;

3. The assets of the company were sold for $26,780.50;

4. The holders of all the preferred stock surrendered their certificates for cancellation in order:

(a) to complete liquidation of the company, and

(b) to effect dissolution of that company;

5. The $26,780.50 received for the assets was distributed to the preferred stockholders pro rata, and

6. Respondent herein received $13,140.25, for the $100,000 it had invested.

7. Also, it is to be supposed that he considered that the preferred stock owned by respondent was non-voting stock, subject to redemption at a fixed price at any time by the corporation, and, on dissolution, subject to preference over common stock on distribution of assets: (R. 49, 50.) These factors placed respondent on but little different basis than if it had been a bondholder.

Applying these facts to the term "sales or exchanges of stock and bonds" as used in section 23(r)(1), there is not a single element which would bring the transaction within the intendment of section 23(r)(1). The minority judge has in effect reached his conclusion by judicial legislation rather than by judicial interpretation.

Section 23(r)(1) uses the simple words "sales or exchanges" for the purpose of limiting the deduction of losses. The concept of "sales and exchanges" is so different from the transaction herein involved that merely to state the proposition is to prove it. Ordinary words, ordinarily used, must be interpreted in their ordinary sense.

The word "sale" in its ordinary sense means a transfer of property for a fixed price in money or its equivalent.

United States v. Benedict (C.C.A. 2), 280 Fed. 76, 80.

A "sale" *is a contract* whereby one acquires property in the article sold and the other parts with it for a valuable consideration.

Vol. 4 *Words and Phrases* (2nd Series) 437;
California Civil Code, Section 1721(2).

"Sale" is not a vague or uncertain word, it is a word of precise legal import, both at law and in equity.

Williamson v. Berry, 8 How. 495, 544, 49 L. Ed. 492, 543.

The word "exchange" is generally regarded as synonymous with "barter", "swap", or "trade"—an exchange of one article for another.

"A 'sale' means for money. An 'exchange of property' is a mere barter or trade."

Ewers v. Weaver, 182 Fed. 713, affirmed (C.C.A. 8), 195 Fed. 249;
Spalding v. C. I. R., 7 B.T.A. 588, 590.

The general and common description of a complete liquidation of a corporation is well expressed by the California statute applicable thereto:

"After determining that all the known debts and liabilities of a corporation in the process of winding up have been paid or adequately provided for, *the directors shall distribute* all the remaining corporate assets among the shareholders according to their respective rights and preferences." (Italics supplied.)
Civil Code, section 401(a).

Following the foregoing legal requirement, the Townsend Company was liquidated. All the elements of a sale or exchange were missing:

(a) The shareholders, like respondent herein, had no election but to accept the distribution;

(b) The directors of the corporation faced a legal duty, from which all contractual elements were missing;

(c) There was no adequacy of consideration, because there was no value to the corporation in the stock which was surrendered to it for liquidation;

(d) The shareholders were not required to give anything in return for the assets distributed, because there was no statutory or contractual requirement that they surrender their stock. The stock could be cancelled on the corporation's books without surrender of the certificates for shares. If surrendered, the certificates would have no value to the corporation;

(e) There was no open market for sale or exchange of either the stock or the assets—the law required the assets to be distributed to the shareholders, something not in the nature of a sale or an exchange.

See: *C. M. Mensies, Inc., v. C. I. R.*, 34 B.T.A. 163, 168.

Comparing the foregoing legal aspects of a distribution in liquidation of a corporation with the factual elements used as a premise by Judge Stephens for his minority decisions (supra), it is clear that his conclusions are unsound both in fact and in law.

No "sales or exchanges of stocks and bonds" require any accounting entries on the part of a corporation, other than entries in the stock transfer ledger. However, when we come to consider the accounting of the corporation in

relation to its status with its stockholders we find a normal situation which precludes the application of any theory of "sales or exchanges". On the books of the corporation we find paid in capital as an asset and outstanding shares of stock as a liability. A situation not comparable with that of vendor and vendee. As long as the stock is outstanding, no matter how often the shares may change possession on "sales or exchanges" and regardless of the value of the consideration paid for stock on "sales or exchanges", the corporation's liability on that outstanding stock remains static. Only when it redeems the stock does the situation change—paid in capital and liability on the outstanding stock are both reduced. The whole transaction is something apart from the stockholder, except that when it comes to a redemption of his stock, whether for more or less than his subscription price, he is compelled to accept what the corporation pays him and the corporate liability is written off on its books. If the redemption of such stock is made in complete liquidation the books of account will not indicate a sale, but the satisfaction of a liability, and cross entries will be made to close the books. While the corporation will remain in possession of the surrendered shares on its liquidation, nevertheless those shares will have no value represented in the closed accounts.

There is a strong parallel between the redemption of shares of preferred stock and bonds issued by a corporation. Both have preferences over subordinate issues and both are subject to the call of the corporation regardless of any desire of the holder to present them for redemption. Yet, the government has consistently claimed that

the redemption of bonds is not a sale or exchange and the courts and the Board of Tax Appeals have sustained that claim.

United States v. Fairbanks, 95 Fed. (2d) 794, 796, Cert. denied by this Court October 10, 1938;

Cook v. Commissioner, 38 B.T.A., No. 87, decided Sept. 29, 1938.

If redemption of bonds is not a "sale or exchange", then redemption of preferred stock should have the same exclusion.

Legislative history was cited by both parties before the Court below and the Board and was considered by both tribunals. Petitioner now asserts that the statute is unambiguous and resort to legislative history is not necessary. After considering the differences of opinion in the decision of the Court below and reading the involvement of sections of the statute which are found in petitioner's brief, the assertion obviously is incorrect. In appendix "B" hereto (pp. iv-vi) we recite the legislative history presented by the respondent herein to the Circuit Court of Appeals. We but summarize the intent of section 23(r)(1) as indicated by the Ways and Means Committee of the House and the Finance Committee of the Senate to show that "distributions by corporations" were never considered by any of the committees as the object at which the section was aimed.

This Court has consistently held that it should turn to legislative history to determine the meaning of doubtful statutes.

Wright v. Mountain Trust Bank, 300 U.S. 440, 463, 464;

Helvering v. New York Trust Co., 292 U.S. 455, 464; *United States v. Katz*, 271 U.S. 354, 357.

Because petitioner has sought an interpretation of section 23(r)(1) far beyond the expressed intent of and the language used by Congress, we point to the legislative history.

In 1932 Congress was confronted with the fact that many taxpayers were avoiding all income tax by selling securities at a loss "in the stock and bond markets" in sufficient amounts to eliminate their gains from all other sources. (Appendix, pp. iv-vi.) The Ways and Means Committee and the Finance Committee were of the opinion that "*some limitation*", not a general limitation, should be placed on permitting the allowance of "*such losses.*" (Appendix, p. iv.) The Treasury Department were in accord with "some limitation" being placed on "the deduction of losses" from the "*sale*" of securities. (Appendix, p. iv.) This limitation always referred to "stock and bond market transactions", "security transactions", "manipulation so as to create fictitious losses", "preventing speculative losses", etc. (Appendix, pp. iv-vi.)

It thus is evident that Congress aimed to limit something far different from "distributions by corporations" and particularly distributions in "complete liquidation of a corporation." It did not contemplate a broad limitation, it sought only to restrict those transactions commonly employed for tax avoidance. Obviously the liquidations of corporations at a loss were too infrequent, too awkward to manipulate, and subject to too many delays to accom-

plish the tax evil upon which Congress sought to place "some limitation".

Petitioner relies entirely upon the contention that the distribution of the liquidating dividend involved in this transaction was such a sale or exchange as came within the limiting provisions of section 23(r)(1). In other words it seeks to enlarge the meaning of the words "sales or exchanges" beyond their common meaning.

Section 23(r) began and closed its existence with the Revenue Act of 1932 (c. 209, 47 Stat. 169), it was a restricted and shortlived special statute. Such a special statute, which did not specifically amend or include by reference other special statutory provisions, can receive only the most restricted interpretation by the Court.

United States v. Barnes, 222 U.S. 513, 519.

Section 23(r)(1), because it limits deductions for losses only to "sales or exchanges of stocks and bonds" without in any way indicating any intent or purpose to enlarge the ordinary meaning of the words "sales or exchanges", must be considered by the Court strictly in the light of the language used in the statute. If there was no sale or exchange within the common meaning of the statutory language, then the question as to whether there was a loss in some other manner has no significance. Congress must be presumed to have used words in their ordinary meaning.

Old Colony R. Co. v. Commissioner, 284 U.S. 552, 560, and cases there cited;

United States v. Kirby Lumber Co., 284 U.S. 1, 3.

Petitioner seeks to distort section 115(c) by interpreting the phrase "shall be *treated* as in part or full payment in exchange for the stock", for *determination* of gain or loss upon the complete liquidation of a corporation under section 111 and recognition under section 112(a), to mean an actual sale or exchange, such as section 23(r)(1) contemplates. The courts should avoid refined or strained analogies such as petitioner seeks to draw in interpreting revenue statutes.

Woolford Realty Co. v. Rose, 286 U.S. 319, 329;
Welsh v. Commissioner, 63 Fed. (2d) 976, aff'd 290 U.S. 111.

When subsection 23(r)(1) was enacted to mitigate a specifically described tax abuse and referred only to "sales or exchanges", without specific limitation on or inclusion of any other transaction, the specific transactions described—"sales or exchanges"—are beyond enlargement by any court. The maxim "*expressio unius est exclusio alterius*" is clearly applicable.

> "'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode' (*Botany Mills v. U. S.*, 278 U.S. 282, 289, 73 L. Ed. 379)."

Paso Robles M. Co. v. Commissioner, 33 Fed. (2d) 653, 654, Cert. den'd. 280 U.S. 595.

What petitioner has been asking for and what the Court below denied falls within the following prohibition:

> "What the government asks is not the construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by

inadvertence, may be included within its scope. To supply omissions transcends the judicial function."

Iselin v. United States, 270 U.S. 245, 251.

The courts may not "graft" something on a statute which is not there.

Smietanka v. First T. & S. Bank, 257 U.S. 602, 606.

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2. UNDER SECTIONS 22(d), 115(c), 111 AND 112 RESPONDENT IS ENTITLED TO DEDUCTION OF ITS LOSS WITHOUT LIMITATION OF ANY OTHER SECTIONS OF THE REVENUE ACT OF 1932.

Petitioner's second specification of alleged error in the decision is that a loss resulting from a corporate liquidation is deductible under the provisions of Sections 22(d), 115(c), and 112 of the Act (The decision, of course, considered Section 111).

Supplement B of subtitle C has legislative entitlement in the index and in the body of the official 1932 Act, viz: "**Computation of Net Income**". Under this heading is Section 115, entitled "**Distributions by Corporations.**"

Section 13, entitled "**Tax on Corporations**", provides that a tax of 13¾% shall be paid "upon the *net income.*"

Section 22(d), entitled "**Distributions by Corporations**", provides: "Distributions by corporations shall be taxable to the shareholders *as provided in section 115.*"

There are *two* parts of the Act devoted to and legislatively entitled "Computation of Net Income"—the first comprising sections 21-26, inclusive, and the second com-

prising sections 111-120, inclusive. The latter part contains the *specific* provisions for handling the *computation* of *net* income where "distributions by corporations" are involved and provides a complete procedure therefor.

There being, then, a complete *specific* procedure for the treatment of distributions in liquidation of a dissolved corporation, such specific statutes, under the universally accepted rule of statutory construction, must prevail over the *general* provisions of section 23.

Kepner v. United States, 195 U.S. 100, 125;
Missouri v. Ross, 299 U.S. 72, 86;
Murphy Oil Co. v. Burnet, 55 Fed. (2d) 17, 25.

Petitioner contends that "the sections relied upon by the majority below do not permit deduction of a loss", but such contention annuls the mandate of 115(c) that "the gain or loss to the distributee * * * *shall* be determined under section 111, but *shall* be *recognized* only to the extent provided in section 112."

Petitioner then argues that *recognizing* a loss does not determine its deductibility. *If that were so, then there never could be any deduction under the act for the* GENERAL *section, 23, says "there shall be* ALLOWED *as deductions"—and "allow" is synonymous with "recognize."*

Webster's New International Dictionary gives the following as synonyms of "recognize": "Own, admit, *allow*, avow, confess."

The fact that the word "recognized" rather than "allowed" was used in 115(c) is of no significance.

"It has, indeed been said that generally, statutes in pari materia ought to receive a uniform construction,

notwithstanding any slight variations of phrase; the object and intention being the same."

Endlich, "Interpretation of Statutes", Sec. 381.

That the object and intention were the same is evident from the fact that both the general and special subdivisions are entitled, within the Act, "Computation of Net Income."

As was approved in *Lynch v. Alworth-Stephens Co.*, 267 U.S. 364 at 370, "the plain, obvious, and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover."

The plain, obvious and rational meaning of the word "recognized" is that the loss must be allowed in "computing the net income", under which heading these sections occur.

Since it is made mandatory that the loss be recognized or allowed as provided in the *specific* statutes, it is not necessary to apply the provisions of the *general* section (23). The Court will not consider that this mandate in the specific statute was an idle gesture by the Congress. The only way a loss can be recognized or allowed is to deduct it from gross income and any other view destroys the obvious intent of section 115(c).

It is the duty of a court in the construction of a statute, to avoid absurdities and to give effect to the evident object and purpose of a legislative act, and the title of the section may be considered for that purpose.

Church of the Holy Trinity v. United States, 143 U.S. 457, 36 L. ed. 226, 228-9.

The title of Supplement B, "Computation of Net Income", makes doubly clear the meaning of the word "recognized" as used in Sections 111, 112 and 115.

The procedure of 115(c) being complete for the purpose of computing the net income (upon which under Section 13 the tax is to be paid), and the mandatory language of 115(c) designating the particular sections to be applied, such mandate necessarily excludes consideration of sections 101 and 23(r)(1), under the maxim "*expressio unius est exclusio alterius.*"

> "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode."
>
> *Botany Worsted Mills v. United States*, 278 U.S. 282 at 289.

Counsel seek to inject section 101 into the discussion, but that section *specifically* [subdivisions (a) and (b)], *excludes corporations,* and, furthermore, it is not referred to in section 115(c)—which provides the complete procedure for the handling of distributions in liquidation of a corporation. Section 101 is not one of the sections included under the heading of "Supplement B—Computation of Net Income." Section 101, like 23(r)(1), not being mentioned in section 115(c), comes also within the maxim, "expressio unius est exclusio alterius."

Petitioner states that "such a limitation of section 115(c) *leaves the capital gain and loss provisions of the statute inapplicable.* Section 101(a) infra, permits taxation of gains from the sale or exchange of capital assets at a 12½% rate." (Italics supplied.)

We entirely agree that section 115(c), by its explicit and mandatory wording, excludes consideration not only of 23(r)(1) but also of 101(a). It is clear from the language of 115(c) that the Congress did not consider that a distribution in liquidation was a sale or exchange, either of capital or non-capital assets, and purposely eliminated any possible application of the general capital gain and loss provisions. *If they had not so intended there would have been no purpose in enacting 115(c).* Absent 115(c), the matter would have been included in the general statutory provisions governing losses.

Article 625 of Regulations 77 (administrative provisions for the 1932 Act) provides:

> "The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and article 561, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113 and articles 591-606; but the gain or loss will be recognized only to the extent provided in section 112 and articles 571-581."

The Court will note that, even in the Treasury Department's interpretation, there is no suggestion of any limitation by section 23(r)(1) or that 101(a) is to be applied to a loss resulting from a corporate dissolution and distribution. The present theory of petitioner is an afterthought—not supported by the Act, the department regulations, or the intent of the Congress.

When we come to carefully consider section 111, to which section 115 specifically refers, and its reference to section 112, we find the following:

(a) Section 111, immediately follows the statutory heading of Supplemental B, entitled **"Computation of Net Income"**, something that cannot be done without deductions of losses from gains.

(b) Section 111 is given the statutory entitlement —**"Determination of amount of gain or loss"**. "Determination means decisive action."

(c) Subsection (a) is entitled **"Computation of gain or loss"**. Computation means the calculation of the results of a transaction to determine whether there is profit or loss.

(d) Subsection (c) is entitled **"Recognition of gain or loss"** and loss may have no recognition under the revenue laws unless it is deductible. The subsection then refers to section 112 for the *determination* of the gain or loss recognizable under section 111.

(e) Section 112(a) provides that *"the entire amount of the* gain or *loss, determined* under section 111, *shall be recognized."*

The foregoing brief analysis should effectively refute the arguments of petitioner and sustain the decision of the Court below.

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3. RESPONDENT IS ENTITLED TO DEDUCTION OF ITS LOSS UNDER SECTION 23(f) BECAUSE OF THE CONTROLLING EFFECT OF SECTIONS 22(d), 115(c), 111 AND 112a.

Petitioner further argues that the loss sustained by respondent is not deductible under section 23. Of course

this argument is based solely on the unsound contention that section 23(f) is so limited by section 23(r)(1) that no deduction may be granted to respondent. Evidently this argument is based upon a statement found in the minority opinion of the Court below, viz.:

> "If losses on liquidation distributions are to be governed by the provisions of section 22(d), 115(c), 111 and 112 without regard to section 23, logic would lead to the conclusion that section 23(r) is in no case to be given effect." (R. p. 74.)

The minority opinion thus ignores the facts, the law, reason and logic; it ignores the breadth of section 23(f) and the narrowness of section 23(r)(1).

As was said in *Baltimore & O. R. Co. v. Western Union Tel. Co.*, 242 Fed. 914, 915, "the right to exchange implies the right to fix the rate, method, or amount of exchange."

In a corporate dissolution, law, not bargaining, fixes what the stockholder shall receive. He has no power to fix the rate, method or amount of exchange. He cannot say how many shares he will surrender nor how much shall be distributed to him. He is not a free agent bargaining with a prospective purchaser. He takes what the law distributes to him.

18 *C. J.* 1291-2 defines "distribution":

> "The act of distributing or dispensing; the act of dividing or portioning among several or many; the act of dividing or making an apportionment; apportionment."

There is no process of "bartering", "swapping" or "trading" between the parties in such a situation; there

is nothing as to price or consideration upon which they must "mutually agree"—for the law fixes just what must be done.

> "Of course, on dissolution of the Finance Company, the title to its property passed to the persons who were its stockholders at the time of the dissolution."
>
> *North Hollywood M. Co. v. North American B., etc., Co.*, 137 Cal. App. 180 at 186.

Section 23(r)(1) by its express terms limits the other subsections of section 23 only as to "losses from sales or exchanges of stocks and bonds." On all other losses sustained by a corporation "during the taxable year and not compensated for by insurance or otherwise", it is entitled to a deduction under section 23(f) by law, reason and logic.

Respondent believes that even if sections 22(d), 115(c), 111, and 112 were in themselves inadequate to permit the deduction, nevertheless the sections define "distributions by corporations" in such a way and fix such a method of computation, determination and recognition of losses thereunder that, under the facts in this case and in accordance with reason and logic, section 23(f) would permit the deduction without possibility of effect from the specific limitation found in section 23(r)(1).

Section 23(r)(1) being a limitation on specific transactions and permitting only specific offsets cannot, as we have argued at length in paragraph 1 of our argument, effect a limitation on other transactions. Note that section 23(r)(1) allows deductions of "losses from sales or exchanges of stocks and bonds" * * * "only to the extent

of the gains from such sales or exchanges." It is difficult to see how gains from "sales or exchanges of stocks and bonds" could, under the wording of the statute and in accord with logic, be offset against losses from the complete liquidation of a corporation. It is more difficult to conceive of the Commissioner of Internal Revenue agreeing to the proposal that the two were akin and that a gain from the liquidation of a corporation might be offset against a loss from a sale of stock. Credulence *in extenso* cannot conceive of the Commissioner conceding such a claim and he would at once submit to section 23(f) rather than permit the injection of what, under such an example, he would claim to be forbidden tax avoidance.

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4. SUPPLEMENTARY REPLY TO PETITIONER'S BRIEF.

Petitioner, by taking segments from the decision of the Court below, seeks to discredit the prevailing decision. The gist of that decision is that "by its terms section 23(r)(1) applies only to 'sales or exchanges'," and that "the liquidating dividend here is neither within the ordinary and accepted meaning of those terms." This conclusion is sound and petitioner has in no way overcome it. What petitioner seeks is to have this Court legislate to extend the meaning of the words "sales or exchanges" and that is beyond the Court's powers.

Heiner v. Donnan, 285 U.S. 312, 331.

Petitioner expends considerable space in arguing as to the capital gain and loss provisions of the Revenue Act of 1932. No capital gain or loss is involved in this matter.

Moreover, the provisions of section 101 relating to capital gains or losses have no application to a corporation, such as petitioner herein contends. Petitioner thus seeks to confuse the argument in this case or seeks to inject the issues in the cases of *White v. United States* (Nos. 96 and 97 of this calendar) where they do not belong. In either event its endeavors are erroneous.

Petitioner seeks to belittle the exemplar stated in the opinion of the Court below (R. p. 70) to show the absurdity of the statutory interpretation sought by it. Only by comparisons may absurdities be shown, and the Court below but followed the precedents of years standing.

Petitioner contends that the "recognition" of a loss under section 112 is not in any sense a determination that the loss is deductible, and argues that, if recognition of a loss under that section permitted deductions, subsections (f) and (r), and other subsections of section 23 which are not here at issue, were needless enactments. In reply we would point out that had Congress not intended to discriminate between various transactions so that some would be taxable, some not subject to tax, some subject to deductions and some not subject to deductions, sections such as 22(d), 22(e), 101, 111, 112, 113, 114, 115 and 116 would never have been enacted.

When it enacted sections 22(d) and 115 giving distributions by corporations a separate taxable status, Congress could not have intended that the recognition of gain or loss could be disturbed by sections of restricted meaning and limited application, such as section 23(r)(1), unless that section contained language to make it applicable or

unless section 115 was amended to show that Congress intended to enlarge the meaning of "distributions in liquidation", so that they fell within the definition of "sales or exchanges", where they do not properly belong in common or legal usage.

IV. CONCLUSION.

It is respectfully submitted that the decision of the United States Circuit Court of Appeals for the Ninth Circuit should be affirmed.

Dated, San Francisco, California,
November 2, 1938.

ADOLPHUS E. GRAUPNER,
ARTHUR E. COOLEY,
Counsel for Respondent.

(Appendicies A and B Follow)

Appendix A

REVENUE ACT OF 1932, c. 209, 47 STAT. 169:

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) **General Definition.**—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * *

(d) **Distributions by Corporations.**—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

(e) **Determination of Gain or Loss.**—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(e) **Losses by Individuals.**—Subject to the limitations provided in subsection (r) of this section, in the case of

an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business;

* * * * * * *

(f) **Losses by Corporations.**—Subject to the limitations provided in subsection (r) of this section, in the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * * * *

(r) **Limitation on Stock Losses.**—(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

* * * * * * *

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) **Computation of Gain or Loss.**—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b), and the loss shall be the excess of such basis over the amount realized.

(b) **Amount Realized.**—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(c) **Recognition of Gain or Loss.**—In the case of a sale or exchange, the extent to which the gain or loss determined under the section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(d) **Installment Sales.**—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) **General Rule.**—Upon the sale or exchange of property the entire amount of the gain or loss determined under section 111, shall be recognized, except as hereinafter provided in this section. * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(c) **Distributions in Liquidation.**—Amount distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. * * *

Appendix B

LEGISLATIVE HISTORY OF SUBSECTION 23(r).

On the revision of the Revenue Act of 1928, C. 852, 45 Stat. 791, by the Revenue Bill of 1932 (H.R. 10,236) the Ways and Means Committee of the House of Representatives proposed five additional and related subsections to Section 23, viz.: (r), (s), (t), (u) and (v), and in so doing stated (H.R. Report No. 708, 72nd Congress, 1st Session, p. 12):

> "Many Taxpayers have been completely *eliminating* from tax their income from salaries, dividends, rents, etc., by deducting therefrom *losses sustained in the stock and bond markets,* with serious effect upon the revenue. Your Committee is of the opinion that *some limitation ought to be placed on the allowance of such losses.*" (Italics supplied.)
>
> • • • • • • •

Note that the committee states "some limitation" was deemed advisable—a clear indication of narrow, rather than broad, limitation. The proposed amendments were aimed at "losses sustained in the stock and bond markets" (supra) and intended to apply to trading losses for, after explaining the reason for excluding "dealers in securities" from the limitations, the Report proceeds to state (p. 13):

> "Traders or other taxpayers *who buy and sell securities for investment and speculation,* whether or not on their own account, and irrespective of whether such *buying or selling* constitutes the carrying on of the trade or business, are not regarded as dealers in securities within the meaning of this rule." (Italics supplied.)
>
> • • • • • • •

After H.R. 10,236, passed the House and was sent to the Senate, the Finance Committee held hearings on the bill and called the then Secretary of the Treasury as a witness. In regard to the proposed addition of subsections 23(r), (s), (t), (u) and (v), the Secretary of the Treasury made explanation to the Committee (Hearings Before the Committee on Finance, United States Senate, Seventy-Second Congress, First Session, on H.R. 10,236, p. 31) as follows:

"In recent years income from business profits, from salaries, and from other sources, has in many cases been offset by losses on *security transactions. It is the effect of such losses* in diminishing the tax upon forms of income, such as I have mentioned, which, to a considerable extent, is responsible for the diminished yield of the income tax in these years."

* * * * * * *

"In other words, people have been able through the taking of *losses on sales of securities* to wipe out any profits by way of dividends, or from business, and so forth. And in some cases *the selling of securities and the taking of losses* have not represented actual losses, but nevertheless they have been enormously effective in wiping out what we have described as other income."

* * * * * * *

"Now, *the Ways and Means Committee felt, and the Treasury agreed,* that the abuse has grown to such a point that something ought to be done about it. * * * So the Treasury did agree with the Ways and Means Committee that you ought to *limit the deduction of losses from the sale of securities,* and that *the loss resulting from sale* of securities should not

be used to wipe out other income." (Italics all supplied.)

* * * * * * *

The Senate Finance Committee amended H.R. 10,236 by reducing the five proposed additions to Section 23 to three, viz.: (r), (s) and (t). In reporting the bill to the Senate, the Committee stated (Senate Report No. 665, 72nd Congress, 1st Session, p. 10):

"The House bill adopted very severe limitations upon the allowance of losses *from the sale of securities,* as a deduction in computing net income. The provisions were based on a twofold policy: (1) Protecting the revenues from the growing practice of reducing tax liabilities by the *sale of securities* on which losses had accrued, and (2) *preventing speculative losses* from wiping out ordinary income, which represents real tax-paying ability." (Italics supplied.)

* * * * * * *

Further in the report (p. 17), the Finance Committee stated, in confirming the Ways and Means Committee explanation of the object sought by amending Section 23 (H.R. Report No. 708, p. 12, supra), as follows:

"Many taxpayers have been completely or partially eliminating from tax their income from salaries, dividends, rents, etc., by deducting therefrom *losses sustained in the stock and bond markets,* with serious effect upon the revenue." (Italics supplied.)